

**Strothman & Company PSC**

Certified Public Accountants & Advisors



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Audited Financial Statements

**Kentucky Higher Education  
Student Loan Corporation**

June 30, 2004

Audited Financial Statements

**Kentucky Higher Education Student Loan Corporation**

June 30, 2004

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## Independent Auditors' Report



Board of Directors  
Kentucky Higher Education Student Loan Corporation  
Louisville, Kentucky

We have audited the accompanying financial statements of each major fund of the Kentucky Higher Education Student Loan Corporation (the Corporation), a blended component unit of Kentucky Higher Education Assistance Authority, (a component unit of the Commonwealth of Kentucky), as of and for the year ended June 30, 2004, which collectively comprise the Corporation's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of each major fund of the Corporation as of June 30, 2004, and the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 3 through 7 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 17, 2004, on our consideration of the Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

A handwritten signature in black ink that reads "Stutman & Company PSC". The signature is written in a cursive, flowing style.

Louisville, Kentucky  
September 17, 2004

Management's Discussion and Analysis (Unaudited)

**Kentucky Higher Education Student Loan Corporation**

June 30, 2004

The Kentucky Higher Education Student Loan Corporation (the Corporation) is an independent *de jure* municipal corporation established by the Kentucky General Assembly in 1978 to provide a loan finance program for postsecondary students in the Commonwealth of Kentucky. The Corporation functions as a lender of student loans, making loans to parents and students directly; a servicer of student loans; and a secondary market for the purchase of student loans from other lenders. The Corporation funds the origination or acquisition of these student loans by periodically issuing bonds and notes under various debt agreements, including its two general bond resolutions. The Corporation also services education loans and collects defaulted education loans. The Corporation's services and loans are marketed under the registered service mark "The Student Loan People<sup>SM</sup>".

This section of the Corporation's annual financial report presents a discussion and analysis of the Corporation's financial performance for the fiscal year ended June 30, 2004. Please read it in conjunction with the Corporation's financial statements and the notes to the financial statements, which follow this section.

**FINANCIAL HIGHLIGHTS AS OF JUNE 30, 2004:**

The Corporation's total assets at year end were approximately \$1.2 billion, which is an increase of approximately \$38 million or 3% over the prior year.

The Corporation's net student loans at year end were approximately \$979 million, which is an increase of approximately \$172 million or 21% over the prior year.

The Corporation's total revenues for the fiscal year ended June 30, 2004 were approximately \$82 million, which is an increase of approximately \$33 million or 68% from the prior fiscal year end.

The Corporation's fee income for the fiscal year ended June 30, 2004 was approximately \$19 million, which is an increase of approximately \$12 million or 165% from the prior fiscal year end.

The Corporation's interest expense for the fiscal year ended June 30, 2004 was approximately \$14 million, which is a decrease of approximately \$3 million or 20% from the prior fiscal year end.

The Corporation's total other operating expenses (excluding the provision for arbitrage liabilities and principal forgiveness) for the fiscal year were approximately \$39 million, which is an increase of approximately \$15 million or 60% from the prior fiscal year end.

The Corporation incurred approximately \$12 million in principal and interest forgiveness due to certain borrower benefit plans. This expense also reduced the excess yield on certain of the Corporation's outstanding bond obligations.

The Corporation's change in net assets after operating transfers for the fiscal year ended June 30, 2004 was approximately \$17 million, which is an increase of approximately \$12 million or more than double (236%) from the prior fiscal year.

Continued

**Kentucky Higher Education Student Loan Corporation**

June 30, 2004

**OVERVIEW OF THE FINANCIAL STATEMENTS:**

The Corporation's financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied on an accrual basis. Under the accrual basis of GAAP, revenues are recognized in the period in which they are earned and expenses are recognized in the period in which they are incurred. These basic financial statements are separated into funds. These requirements, as well as certain governmental accounting pronouncements, require this financial statement presentation.

The three basic financial statements presented within the financial statements are:

Balance Sheet

This statement presents information regarding the Corporation's assets, liabilities and net assets. Net assets represent the total amount of assets less the total liabilities. The balance sheet classifies assets, liabilities and classifies net assets as current, noncurrent, restricted and unrestricted according to restrictions in each general bond resolution.

Statement of Revenues, Expenses and Change in Net Assets

This statement presents the Corporation's interest income, cost of funds, operating expenses and change in net assets for the fiscal year.

Statement of Cash Flows

The Corporation's statement of cash flows is presented using the direct method of reporting, which reflects cash flows from operating, investing, non-capital and capital financing activities.

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Management's Discussion and Analysis (Unaudited)--Continued

**Kentucky Higher Education Student Loan Corporation**

June 30, 2004

**FINANCIAL ANALYSIS OF THE CORPORATION**

The Corporation's total net assets at June 30, 2004 were approximately \$100 million, which is an increase of approximately \$17 million or 20% over June 30, 2003. Components of the Corporation's balance sheets as of June 30, 2004 and 2003 were as follows:

<b>Net Asset Information June 30, 2004 and 2003</b>	<b>2004</b>	<b>2003</b>	<b>Increase (Decrease)</b>	<b>%</b>
<b>Assets</b>				
Loans	\$ 978,578,931	\$ 806,743,657	\$ 171,835,274	21%
Capital Assets	2,329,161	2,244,707	84,454	4%
Other Assets	192,031,561	326,781,755	(134,750,194)	-41%
<b>Total Assets</b>	<b>\$ 1,172,939,653</b>	<b>\$ 1,135,770,119</b>	<b>\$ 37,169,534</b>	<b>3%</b>
<b>Liabilities and Net Assets</b>				
Short and Long-term debt	\$ 1,045,450,000	\$ 1,023,050,000	\$ 22,400,000	2%
Other Liabilities	27,144,220	29,131,862	(1,987,642)	7%
<b>Total Liabilities</b>	<b>1,072,594,220</b>	<b>1,052,181,862</b>	<b>20,412,358</b>	<b>2%</b>
<b>Net Assets</b>				
Invested in Capital Assets	2,329,161	2,244,707	84,454	4%
Restricted	86,061,379	69,988,080	16,073,299	23%
Unrestricted	11,954,893	11,355,470	599,423	53%
<b>Total Net Assets</b>	<b>100,345,433</b>	<b>83,588,257</b>	<b>16,757,176</b>	<b>20%</b>
<b>Total Liabilities and Net Assets</b>	<b>\$ 1,172,939,653</b>	<b>\$ 1,135,770,119</b>	<b>\$ 37,169,534</b>	<b>3%</b>

The increase noted above in the Corporation's total assets is the continuation of a trend of growth in prior years. Total assets grew from approximately \$1.136 billion at June 30, 2003 to approximately \$1.173 billion at June 30, 2004. Net loans outstanding totaled \$979 million at June 30, 2004, a \$172 million increase over June 30, 2003. This increase included \$349 million in loan acquisitions (both originations and purchases) offset by borrower payments, consolidation loan payments and principal forgiveness on the loans. Other assets decreased by \$135 million as a result of improved cash management strategies which converted cash and cash equivalents into loans. During fiscal year 2004, the Corporation drew down a net amount of approximately \$41 million from the 2000 Line of Credit to acquire student loans. The amount was offset by approximately \$19 million in bond maturities. This increase was the largest component of the Corporation's increase in its total liabilities. Other liabilities decreased \$2 million primarily as a result of a decrease in the allowance for arbitrage liabilities.

Continued

Management's Discussion and Analysis (Unaudited)--Continued

**Kentucky Higher Education Student Loan Corporation**

June 30, 2004

The Corporation's change in net assets for the year ended June 30, 2004 was approximately \$17 million, which is an increase of approximately \$12 million or more than double the change in net assets for the year ended June 30, 2003. Components of the Corporation's statements of revenues, expenses and change in net assets as of June 30, 2004 and 2003 were as follows:

**Revenues, Expenses and Change in Net Assets Data**  
**Years Ended June 30, 2004 and 2003**

	<b>2004</b>	<b>2003</b>	<b>Increase (Decrease)</b>	<b>%</b>
<b>Revenues</b>				
Loan Interest Income	\$ 61,455,867	\$ 38,595,613	\$ 22,860,254	59%
Investment Interest Income	1,806,139	3,122,183	(1,316,044)	-42%
<b>Total Interest Income</b>	<b>63,262,006</b>	<b>41,717,796</b>	<b>21,544,210</b>	<b>52%</b>
Fee Income	18,715,709	7,066,613	11,649,096	165%
<b>Total Revenues</b>	<b>81,977,715</b>	<b>48,784,409</b>	<b>33,193,306</b>	<b>68%</b>
<b>Expenses</b>				
Interest Expense on Debt	13,957,461	17,428,209	(3,470,748)	-20%
Provision for Arbitrage Liabilities	(672,944)	(6,641,872)	5,968,928	-90%
Principal Forgiveness	9,672,561	5,514,745	4,157,816	75%
Financing and Origination Fees	6,265,975	5,738,785	527,190	9%
Federal Consolidation Fees	2,417,030	1,739,581	677,449	39%
Personnel and Professional Services	10,482,674	8,038,764	2,443,910	30%
General Administration	20,097,782	8,977,827	11,119,955	124%
<b>Total Expenses</b>	<b>62,220,539</b>	<b>40,796,039</b>	<b>21,424,500</b>	<b>53%</b>
<b>Change in Net Assets Before Operating Transfers</b>	<b>19,757,176</b>	<b>7,988,370</b>	<b>11,768,806</b>	<b>147%</b>
<b>Transfer to the Authority</b>	<b>(3,000,000)</b>	<b>(3,000,000)</b>	<b>0</b>	
<b>Change in Net Assets</b>	<b>\$ 16,757,176</b>	<b>\$ 4,988,370</b>	<b>\$ 11,768,806</b>	<b>236%</b>

Continued



**Kentucky Higher Education Student Loan Corporation**

June 30, 2004

Interest Income, which includes interest on loans and investments, increased by 52% due to certain loans qualifying for the minimum 9.5% yield allowed under special allowance rules. Therefore, the average yield from interest on loans in FY 2004 increased to 6.74% from 4.26% in FY 2003. Given the declining interest rate environment, investment yields declined from 1.33% in FY 2003 to .81% in FY 2004. Fee income increased due to growth of a portfolio for a large client for whom the Corporation performs third-party servicing activities and to certain reclassifications. Interest on debt decreased by 20% due to declining interest rates on the variable rate bonds outstanding. Average rates declined from 1.87% in FY 2003 to 1.32% in FY 2004. Certain borrower benefits resulted in loan and interest forgiveness of approximately \$12 million which had the effect of reducing the excess yield on certain of the Corporation's outstanding bond obligations. Other operating expenses increased 60% due to costs related to the growing loan portfolio as the Corporation adds loan and servicing volume and to certain reclassifications.

**CONDITIONS AFFECTING FINANCIAL POSITION:**

At June 30, 2004, the Corporation was servicing and committed to purchase student loans from other lenders with a principal balance of approximately \$49 million. The total portfolio of student loans that the Corporation owns, services for other lenders, and collects was approximately \$5.7 billion at June 30, 2004. This is an increase of approximately \$1.5 billion or 35% higher than as of June 30, 2003.

The Corporation continues to experience significant growth in all aspects of its operations and the Corporation's fiscal year 2005 budget reflects continued growth. Efforts to increase the Corporation's lending market share in the Commonwealth and the continued high rate of growth in the client servicing portfolio is expected to promote the sustained growth pattern for the Corporation throughout the coming fiscal year. The Corporation has added additional staff to perform the additional work associated with this significant growth and its anticipated expense increase for fiscal year 2005 reflect the additional costs expected to be incurred as a result of the additional student loan volume.

Available and affordable funds from debt financings enable the Corporation to meet its lending demand for loans originated and purchased. Historically, the Corporation has issued primarily tax-exempt debt. However, since 1997 the Corporation has supplemented its tax-exempt funding with taxable debt at a higher interest cost. Annually, the Corporation receives an allocation from the Commonwealth's Private Activity Bond Allocation committee which authorizes the amount of tax-exempt debt that the Corporation can issue. As of June 30, 2004, the Corporation's tax-exempt debt outstanding was 43% of the total bonds outstanding. In addition to funds provided by debt issuances, the Corporation also has a \$100 million line of credit with Bank of America for loan acquisitions. This line of credit provides additional liquidity in the event that loan demand exceeds the available funds from debt issuances. The Corporation has secured this line of credit through December 31, 2004 and expects to renew or replace this funding source to ensure available funds throughout fiscal year 2005. The Corporation and its trustee monitor the maturities of all debt instruments and the appropriate levels in the debt service and debt service reserve accounts. Approximately \$57 million in bonds will mature during fiscal year 2005 and there are no scheduled bond maturities in fiscal year 2006. The Corporation expects its student loan payment stream to provide adequate cash flows to meet its debt service requirements.

Balance Sheet

**Kentucky Higher Education Student Loan Corporation**

June 30, 2004

<b>Assets</b>	<b>Education Finance Funds</b>	<b>Operating Fund</b>	<b>Combined Totals</b>
<b>Current</b>			
Cash and Cash Equivalents	\$ 67,999,625	\$ 5,639,133	\$ 73,638,758
Investments		7,673,025	7,673,025
Receivables and Prepaid Expenses	7,021	1,378,023	1,385,044
Accrued Interest Income	16,670,071	3,418	16,673,489
Special Allowance Receivable	13,655,293		13,655,293
Interfund Receivable (Payable)	(868,610)	868,610	0
<b>Total Current Assets</b>	<b>97,463,400</b>	<b>15,562,209</b>	<b>113,025,609</b>
<b>Noncurrent</b>			
Loans, Net	978,578,931		978,578,931
Cash and Cash Equivalents	60,093,237		60,093,237
Deferred Debt Issuance Cost	4,616,813		4,616,813
Deferred Loan Purchase Premiums and Origination Costs, Net	14,295,902		14,295,902
Property and Equipment, Less Accumulated Depreciation		2,329,161	2,329,161
<b>Total Noncurrent Assets</b>	<b>1,057,584,883</b>	<b>2,329,161</b>	<b>1,059,914,044</b>
<b>Total Assets</b>	<b>\$ 1,155,048,283</b>	<b>\$ 17,891,370</b>	<b>\$ 1,172,939,653</b>
<b>Liabilities</b>			
<b>Current</b>			
Accounts Payable and Accrued Expenses	\$ 1,719,792	\$ 3,454,129	\$ 5,173,921
Interest Payable	1,324,273		1,324,273
Bonds/Note Payable	98,200,000		98,200,000
Due to the Authority		153,187	153,187
<b>Total Current Liabilities</b>	<b>101,244,065</b>	<b>3,607,316</b>	<b>104,851,381</b>
<b>Noncurrent</b>			
Bonds/Note Payable	947,250,000		947,250,000
Allowance for Arbitrage Liabilities	20,492,839		20,492,839
<b>Total Noncurrent Liabilities</b>	<b>967,742,839</b>		<b>967,742,839</b>
<b>Total Liabilities</b>	<b>1,068,986,904</b>	<b>3,607,316</b>	<b>1,072,594,220</b>
<b>Net Assets</b>			
Invested in Capital Assets		2,329,161	2,329,161
Restricted	86,061,379		86,061,379
Unrestricted		11,954,893	11,954,893
<b>Total Net Assets</b>	<b>86,061,379</b>	<b>14,284,054</b>	<b>100,345,433</b>
<b>Total Liabilities and Net Assets</b>	<b>\$ 1,155,048,283</b>	<b>\$ 17,891,370</b>	<b>\$ 1,172,939,653</b>

See Notes to Financial Statements

Statement of Revenues, Expenses and Change in Net Assets

**Kentucky Higher Education Student Loan Corporation**

Year Ended June 30, 2004

	<b>Education Finance Funds</b>	<b>Operating Fund</b>	<b>Combined Totals</b>
<b>Revenues</b>			
Interest on Loans	\$ 61,097,856	\$ 52,853	\$ 61,150,709
Late Payment Penalties	304,174	984	305,158
Interest on Investments	1,694,133	112,006	1,806,139
Debt Recovery Commission		142,845	142,845
Servicing Fees		6,854,820	6,854,820
Service/Administration Fees		11,718,044	11,718,044
<b>Total Revenues</b>	<b>63,096,163</b>	<b>18,881,552</b>	<b>81,977,715</b>
<b>Expenses</b>			
Interest on Debt	13,957,461		13,957,461
Amortization of Bond Issuance Costs	292,007		292,007
Variable Bond Credit Facility and Remarketing Fees	2,657,558		2,657,558
Reduction in Arbitrage Liabilities	(672,944)		(672,944)
Amortization of Loan Purchase Premiums and Origination Costs	3,316,410		3,316,410
Depreciation and Amortization		1,533,517	1,533,517
Federal Consolidation Fees	2,417,030		2,417,030
Personnel and Professional Services		10,482,674	10,482,674
General Administrative Expenses		5,679,926	5,679,926
Provision for Student Loan Loss	271,625	501,558	773,183
Principal Forgiveness Under Borrower Benefit Programs	9,672,561		9,672,561
Servicing and Administration Fees	11,718,044		11,718,044
Other Expenses	393,112		393,112
<b>Total Expenses</b>	<b>44,022,864</b>	<b>18,197,675</b>	<b>62,220,539</b>
<b>Operating Income</b>	<b>19,073,299</b>	<b>683,877</b>	<b>19,757,176</b>
Transfer to the Authority	(3,000,000)		(3,000,000)
<b>Increase in Net Assets</b>	<b>16,073,299</b>	<b>683,877</b>	<b>16,757,176</b>
<b>Net Assets at Beginning of Year</b>	<b>69,988,080</b>	<b>13,600,177</b>	<b>83,588,257</b>
<b>Net Assets at End of Year</b>	<b>\$ 86,061,379</b>	<b>\$ 14,284,054</b>	<b>\$ 100,345,433</b>

See Notes to Financial Statements

Statement of Cash Flows

**Kentucky Higher Education Student Loan Corporation**

Year Ended June 30, 2004

	<b>Education Finance Funds</b>	<b>Operating Fund</b>	<b>Combined Totals</b>
<b>Cash Flows From Operating Activities</b>			
Principal Received on Loans	\$ 175,774,555	\$ (38,394)	\$ 175,736,161
Interest on Loans	24,291,157	53,839	24,344,996
Special Allowance	15,899,746		15,899,746
Client Loan Receipts		747,389,696	747,389,696
Servicing Fees		7,117,246	7,117,246
Debt Recovery Commission		183,273	183,273
Loans Purchased, including Premiums	(21,612,995)	(618,553)	(22,231,548)
Loans Originated, including Costs	(335,203,777)		(335,203,777)
Credit Facility Fees	(2,632,205)		(2,632,205)
Loan Receipts Remitted to Clients		(747,103,180)	(747,103,180)
Other Expenses	(14,985,643)	(4,809,077)	(19,794,720)
<b>Net Cash Provided By (Used In) Operating Activities</b>	<b>(158,469,162)</b>	<b>2,174,850</b>	<b>(156,294,312)</b>
<b>Cash Flows From Investing Activities</b>			
Investment Income	1,827,354	115,600	1,942,954
Proceeds from Sales and Maturities of Investments		12,600,000	12,600,000
Purchases of Investments		(13,890,123)	(13,890,123)
<b>Net Cash Provided By (Used In) Investing Activities</b>	<b>1,827,354</b>	<b>(1,174,523)</b>	<b>652,831</b>
<b>Cash Flows From Noncapital Financing Activities</b>			
Proceeds from Debt Issued	91,280,000		91,280,000
Debt Issuance Costs	(170,540)		(170,540)
Debt Principal Payments	(68,880,000)		(68,880,000)
Interest on Debt	(13,935,294)		(13,935,294)
Transfer to the Authority	(3,000,000)		(3,000,000)
<b>Net Cash Provided By Noncapital Financing Activities</b>	<b>5,294,166</b>		<b>5,294,166</b>
<b>Cash Flows From Capital and Related Financing Activities</b>			
Property and Equipment Acquired		(1,633,841)	(1,633,841)
<b>Net Cash Used In Capital and Related Financing Activities</b>		<b>(1,633,841)</b>	<b>(1,633,841)</b>
<b>Net Decrease in Cash and Cash Equivalents</b>	<b>(151,347,642)</b>	<b>(633,514)</b>	<b>(151,981,156)</b>
<b>Cash and Cash Equivalents at Beginning of Year</b>	<b>279,440,504</b>	<b>6,272,647</b>	<b>285,713,151</b>
<b>Cash and Cash Equivalents at End of Year</b>	<b>\$ 128,092,862</b>	<b>\$ 5,639,133</b>	<b>\$ 133,731,995</b>

Continued

Statement of Cash Flows--Continued

**Kentucky Higher Education Student Loan Corporation**

Year Ended June 30, 2004

	<b>Education Finance Funds</b>	<b>Operating Fund</b>	<b>Combined Totals</b>
<b>Operating Income</b>	<b>\$ 19,073,299</b>	<b>\$ 683,877</b>	<b>\$ 19,757,176</b>
Income and Expense Items not Affecting Cash Provided By (Used In)			
Operating Activities			
Investment Income	(1,827,354)	(115,600)	(1,942,954)
Depreciation and Amortization		1,533,517	1,533,517
Loss on Equipment Disposal		15,870	15,870
Amortization of Bond Issuance Costs	292,007		292,007
Amortization of Loan Purchase Premiums and Origination Costs	3,316,410		3,316,410
Interest on Debt	13,957,461		13,957,461
Provision for Loan Losses	271,625	501,558	773,183
Borrower Interest Converted to Principal	(11,648,458)		(11,648,458)
Principal Forgiveness	9,672,561		9,672,561
Interest Forgiveness	2,512,721		2,512,721
Net Change in Fair Value of Investments		2,274	2,274
Items Not Accounted for as Revenues or Expenses			
Principal Received on Loans	175,774,555	(38,394)	175,736,161
Loans Purchased, including Premiums	(21,612,995)	(618,553)	(22,231,548)
Loans Originated, including Costs	(335,203,777)		(335,203,777)
(Increase) Decrease in Assets			
Receivables and Prepaid Expenses	477,824	(398,729)	79,095
Accrued Interest	557,020	1,323	558,343
Special Allowance Receivable	(12,499,187)		(12,499,187)
Interfund Receivable/Payable	(468,896)	468,896	0
Increase (Decrease) in Liabilities			
Accounts Payable and Accrued Expenses	(441,035)	138,811	(302,224)
Allowance for Arbitrage Liabilities	(672,943)		(672,943)
<b>Net Cash Provided By (Used In) Operating Activities</b>	<b><u>\$ (158,469,162)</u></b>	<b><u>\$ 2,174,850</u></b>	<b><u>\$ (156,294,312)</u></b>

See Notes to Financial Statements

**Kentucky Higher Education Student Loan Corporation**

June 30, 2004

**Note 1--Description of Business and General Bond Resolutions**

The Kentucky Higher Education Student Loan Corporation (the Corporation) is an independent *de jure* municipal corporation established by the Kentucky General Assembly in 1978 to provide a loan finance program for postsecondary students in the Commonwealth of Kentucky (the "Commonwealth"). Governed by a Board of Directors, the Corporation is authorized to finance loans for students attending eligible postsecondary institutions, service and collect education loans, and issue bonds and notes not to exceed \$1.95 billion in order to carry out its corporate powers and duties. The Corporation's education finance, servicing and collection activities include: (i) the origination and secondary market acquisition of education loans originated pursuant to the Federal Family Education Loan Program (FFELP); (ii) the financing of FFELP Loans; (iii) the servicing of FFELP Loans and other education loans, and (iv) the collection of FFELP Loans and other education loans for other holders on a commission or cost reimbursement basis. The FFELP student loans held, serviced and collected by the Corporation include Federal Stafford Loans (Stafford), Unsubsidized Stafford Loans (Unsubsidized Stafford), Federal Supplemental Loans for Students (SLS), Federal Parent Loans for Undergraduate Students (PLUS), and Federal Consolidation Loans (Consolidations).

The FFELP loans held by the Corporation are insured by the Kentucky Higher Education Assistance Authority (the Authority), as the state guarantee agency, or the U. S. Department of Education (USDE). Loans made prior to October 1, 1993, are 100% insured. Loans made on or after October 1, 1993, are 100% insured against borrowers' death, disability, or bankruptcy and 98% insured against borrowers' default.

The Corporation's General Bond Resolutions (GBRs) and separate Series Resolutions for issue of revenue bonds contain provisions establishing funds and accounts for the segregation of assets and provisions restricting the use of the proceeds of bonds and other funds received.

As of June 30, 2004, the Corporation serviced approximately \$979 million outstanding principal amount of FFELP Loans which are pledged pursuant to the 1983 GBR, the 1997 GBR or the 2000 Line of Credit Trust Agreement and approximately \$4.6 billion of FFELP Loans and other education loans on behalf of other holders, including holders with national lending operations. The majority of such education loans are being serviced by the Corporation pursuant to servicing agreements which do not provide for the acquisition by the Corporation of the education loans serviced. As a servicer of FFELP loans, the Corporation collects student loan remittances and subsequently disburses these remittances to the appropriate lending entities. In addition, the Corporation currently collects approximately \$158 million of FFELP Loans and other education loans for other holders on a commission or cost reimbursement basis. The Corporation's obligations pursuant to such servicing and collection agreements are without recourse to assets pledged to collateralize any Corporation financings.

**Kentucky Higher Education Student Loan Corporation**

June 30, 2004

**Note 2--Summary of Significant Accounting Policies**

(a) Reporting Entity

The Corporation is a blended component unit agency of the Authority (a component unit of the Commonwealth of Kentucky).

(b) Basis of Presentation

The Corporation's basic financial statements are prepared in accordance with Governmental Accounting Standards Board Statement No. 34, "Basic Financial Statements and Management Discussion and Analysis - for State and Local Governments" (GASB 34). The basic financial statements are comprised of fund financial statements and notes to the financial statements. The fund financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America applicable to state government entities, which provide that financial activities operated similarly to private business enterprises be presented as separate proprietary funds and that accounting results be organized by funds to account for specific activities consistent with legal and operating requirements. The Corporation's funds include the Education Finance Funds and the Operating Fund. The Education Finance Funds include loan programs funded individually under financings under the 1983 General Bond Resolution, the 1997 General Bond Resolution and the Line of Credit.

Financial activities operated similarly to private business enterprises and financed through fees for servicing and defaulted loan collection are presented under the Operating Fund. The Corporation follows all applicable Governmental Accounting Standards Board pronouncements, as well as Financial Accounting Standards Board pronouncements and Accounting Principles Board Opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The Corporation uses the accrual basis of accounting.

(c) Loan Losses

As discussed in Note 1, the Corporation's FFELP loans are guaranteed by the Authority. Management of the Corporation believes that the Authority will be able to honor all default claims submitted by the Corporation. However, the Corporation records a provision for loan losses based upon its expected default claims with respect to 98% insured loans and for loans with certain loan servicing violations. The allowance for loan losses on FFELP loans was \$872,581 for loan principal and \$138,985 for accrued interest as of June 30, 2004. Furthermore, the Corporation is required to purchase loans owned by third party customers with certain loan servicing violations. As of June 30, 2004, the allowance for third-party servicing loan losses was \$1,648,266 for loan principal and \$114,830 for accrued interest.

(d) Investments

Investments, which consist principally of securities of the federal government or its agencies and commercial paper, are reported at fair market value. Fair market value is determined by using quoted market prices as of the last day of the fiscal year.

Continued

**Kentucky Higher Education Student Loan Corporation**

June 30, 2004

**Note 2--Summary of Significant Accounting Policies--Continued**

(e) Interest Income on Loans

The Corporation earns interest income on loans from three sources: (1) the USDE for subsidized interest earned while certain students are in certain statuses; (2) special allowance subsidies (discussed in Footnote 6); and (3) the borrowers. All interest is recorded when earned and is shown in the financial statements net of the interest related portion of the provision for loan losses.

(f) Servicing Fees

The Corporation's fees for servicing loans held by third parties are recorded as servicing fee revenue when earned. These third-party loans are not presented on the balance sheet as they are not owned by the Corporation.

(g) Income Taxes

The Corporation is an independent *de jure* municipal corporation and political subdivision of the Commonwealth of Kentucky and is therefore not subject to federal or state income taxes.

(h) Deferred Bond Issuance Costs

Bond issuance costs are deferred and amortized over the life of the bonds, utilizing the bonds outstanding method, which approximates the effective interest method.

(i) Deferred Loan Purchase Premiums and Deferred Loan Origination Costs

Loan purchase premiums and certain origination costs are deferred and amortized over the estimated life of the loans acquired or originated, based on projected balances outstanding, which approximates the effective interest method.

(j) Interfund Eliminations

Receivables and payables among the funds of the Corporation are eliminated in the balance sheet.

(k) Property and Equipment

Office furnishings, equipment, and system development costs are recorded at cost and depreciated over their estimated useful lives using the straight-line method.

(l) Statement of Cash Flows

For the statement of cash flows, the Corporation considers cash and cash equivalents to include money market funds and highly liquid investments which mature within one month of purchase.

Continued



Notes to Financial Statements--Continued

**Kentucky Higher Education Student Loan Corporation**

June 30, 2004

**Note 2--Summary of Significant Accounting Policies--Continued**

(m) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Note 3--Cash, Cash Equivalents and Investments**

Cash, cash equivalents and investments as of June 30, 2004, are summarized below:

Cash	\$ 1,807,737
Cash Equivalents	131,924,258
Investments	<u>7,673,025</u>
Total	<u>\$ 141,405,020</u>

Deposits, identified as cash in the above summary, are as follows as of June 30, 2004:

	<u>Financial Statement Amount</u>	<u>Bank Balance</u>
Insured (FDIC)	\$ 200,000	\$ 200,000
Uninsured and uncollateralized	<u>1,607,737</u>	<u>1,944,940</u>
Total	<u>\$ 1,807,737</u>	<u>\$ 2,144,940</u>

The following is a summary of investments, including cash equivalents, categorized as of June 30, 2004:

	<u>Category 1</u>	<u>Uncategorized</u>	<u>Total</u>
U.S. Treasury and Government Agency Obligations	\$ 10,844,529		\$ 10,844,529
Government Mutual Funds		\$ 42,977,692	42,977,692
Money Market Securities		<u>85,775,062</u>	<u>85,775,062</u>
Total	<u>\$ 10,844,529</u>	<u>\$ 128,752,754</u>	<u>\$ 139,597,283</u>

Continued

Notes to Financial Statements--Continued

**Kentucky Higher Education Student Loan Corporation**

June 30, 2004

**Note 3--Cash, Cash Equivalents and Investments--Continued**

The Corporation's investments are categorized to give an indication of the level of risk assumed by the Corporation at year-end. Category 1 includes investments that are insured, registered, or for which the securities are held by the Corporation or its agent in the Corporation's name.

**Note 4--Loans**

The Corporation originates, purchases and holds various types of student loans as described in Note 1. The terms of these loans, which vary on an individual basis depending upon loan type and the date the loan was originated, generally provide for repayment in monthly installments of principal and interest over a period of up to thirty years for Consolidation loans and generally up to ten years for other loans. The repayment period begins after a grace period of six months following graduation or loss of qualified student status for the Subsidized and Unsubsidized Stafford loans. The repayment period for Consolidation, SLS and PLUS loans begins within 60 days from the date the loan is fully disbursed. Interest rates on student loans ranged from 2.82% to 12% for the fiscal year ended June 30, 2004 depending upon the type and date of origination of the individual loan.

Loans consist of the following at June 30, 2004:

Stafford – Subsidized	\$ 407,154,009
Stafford – Unsubsidized	291,341,583
PLUS/SLS	22,221,486
Consolidation	258,842,655
Other	<u>1,540,045</u>
Total Gross Loans	981,099,778
Allowance for loan loss	<u>(2,520,847)</u>
Net Loans	978,578,931
Net deferred premium and loan costs	<u>14,295,902</u>
<b>Net Loans and Deferred Premium and Loan Costs</b>	<b><u>\$ 992,874,833</u></b>

All student loans are guaranteed as to principal and accrued interest. In order for the loans to be or remain guaranteed, certain due diligence requirements in loan servicing must be met. As of June 30, 2004, \$2,660,554 of student loans were no longer considered guaranteed due to violation of due diligence requirements.

The Corporation withholds certain origination fees from the loan disbursements on FFELP loans to the borrowers and remits these fees to USDE. The amount of the origination fees is based on a percentage of the gross loan amount.

Continued

Notes to Financial Statements--Continued

**Kentucky Higher Education Student Loan Corporation**

June 30, 2004

**Note 4--Loans--Continued**

The Corporation is also required to pay to USDE certain Lender and Rebate Fees. The amount of the Lender Fees is based on a certain percentage of the gross loan amount on all FFELP loans originated after October 1, 1993 and a certain percentage of the carrying value of the Consolidation loans.

Loan origination costs are capitalized when the loan is made and are amortized using the projected balances outstanding method which approximates the effective interest method, over the estimated economic life of the loan. The capitalized loan origination costs, net of accumulated amortization, at June 30, 2004, were \$14,295,902.

Generally, student loans of the Corporation are pledged as collateral for the various obligations of the Corporation.

**Note 5--Property and Equipment**

A summary of Property and Equipment follows:

	<b>Beginning Balance July 1 2003</b>	<b>Additions</b>	<b>Disposals</b>	<b>Ending Balance June 30 2004</b>
Furniture	\$ 1,412,628	\$ 216,775	\$ 2,562	\$ 1,626,841
Computer Equipment	3,541,862	1,395,348	132,250	4,804,960
Other Equipment	187,585	37,718	16,230	209,073
System Development – Information Services	55,955			55,955
Student Loan Servicing System	541,131			541,131
Debt Recovery System	139,350			139,350
Total Property and Equipment	5,878,511	1,649,841	151,042	7,377,310
Less accumulated depreciation	3,633,804	1,533,517	119,172	5,048,149
<b>Net Property and Equipment</b>	<b>\$ 2,244,707</b>	<b>\$ 116,324</b>	<b>\$ 31,870</b>	<b>\$ 2,329,161</b>

**Kentucky Higher Education Student Loan Corporation**

June 30, 2004

**Note 6--Special Allowance**

The U.S. Department of Education pays a special allowance to the Corporation after the end of each quarter representing supplemental interest on outstanding, insured loans. Certain FFELP loans disbursed during the period from January 1, 2000 through June 30, 2004, receive special allowance at a rate based upon the average of the bond equivalent rates of the 3-month commercial paper rate as reported by the U.S. Federal Reserve. Other eligible loans receive special allowance based on the 91-day U.S. Treasury bill rates. Certain loans financed through bonds dated prior to October 1, 1993 receive a 9.5% minimum rate of return based on provisions of the Higher Education Act of 1965, as amended, and related interpretations by the USDE. Possible changes in legislation and/or USDE interpretations in the future could cause this benefit to be reduced or eliminated; however, management does not expect any such changes to be retroactive.

**Note 7--Principal and Interest Forgiveness**

During fiscal year 2004, the Corporation forgave \$9,672,561 in loan principal and \$2,512,721 in accrued interest for certain borrowers who were teachers or nurses that worked in the Commonwealth of Kentucky and students who completed the academic period for which their loan was made.

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Notes to Financial Statements--Continued

**Kentucky Higher Education Student Loan Corporation**

June 30, 2004

**Note 8--Revenue Bonds**

The balance of revenue bonds at June 30, 2004 and the related activity for the year ended June 30, 2004 is as follows (in thousands):

<u>Series</u>	<u>Scheduled Maturity</u>	<u>Interest Rate</u>	<u>Beginning Balance July 1, 2003</u>	<u>Bond Maturities</u>	<u>New Issues</u>	<u>Ending Balance June 30, 2004</u>
<b><u>1983 General Bond Resolution</u></b>						
1991 E	December 1, 2011	Weekly**	\$ 46,000,000			\$ 46,000,000
1993B	Semi-Annually in various amounts through December 1, 2005	4.90% to 5.30%	55,800,000	\$ (18,880,000)		36,920,000
1996 A	June 1, 2026	Weekly**	25,000,000			25,000,000
2003 A	December 1, 2032	Every 35 Days	20,600,000			20,600,000
2003 B	June 1, 2005	1.65%	20,000,000			20,000,000
<b><u>1997 General Bond Resolution</u></b>						
1997 A-1	May 1, 2027	Every 35 days**	45,250,000			45,250,000
1997 A-2	May 1, 2027	Every 35 days**	45,200,000			45,200,000
1997 B	May 1, 2027	Every 35 days**	44,550,000			44,550,000
1998 A-1	May 1, 2028	Every 28 days**	36,400,000			36,400,000
1998 A-2	May 1, 2028	Every 28 days**	36,400,000			36,400,000
1998 B	May 1, 2028	Every 35 days**	42,200,000			42,200,000
1999 A	May 1, 2029	Every 28 days**	51,350,000			51,350,000
1999 B	May 1, 2029	Every 35 days**	23,650,000			23,650,000
2000 A-1	May 1, 2030	Every 28 days**	42,100,000			42,100,000
2000 A-2	May 1, 2030	Every 28 days**	42,100,000			42,100,000
2000 A-3	May 1, 2030	Every 35 days**	42,050,000			42,050,000
2000 B	May 1, 2030	Every 35 days**	23,750,000			23,750,000
2001 A-1	May 1, 2031	Every 35 days**	59,850,000			59,850,000
2001 A-2	May 1, 2031	Every 35 days**	59,850,000			59,850,000
2001 B	May 1, 2031	Every 35 days**	30,300,000			30,300,000
2002 A-1	May 1, 2032	Every 28 days**	55,450,000			55,450,000
2002 A-2	May 1, 2032	Every 35 days**	55,450,000			55,450,000
2002 A-3	May 1, 2032	Every 35 days**	39,100,000			39,100,000
2003 A-1	May 1, 2033	Every 35 days**	63,700,000			63,700,000
2003 A-2	May 1, 2033	Every 35 days**	16,950,000			16,950,000
Total			<u>\$1,023,050,000</u>	<u>\$ (18,880,000)</u>	<u>\$ -</u>	<u>\$1,004,170,000</u>

\*\* Variable interest rate changes based on specified indices.

Continued

Notes to Financial Statements--Continued

**Kentucky Higher Education Student Loan Corporation**

June 30, 2004

**Note 8--Revenue Bonds--Continued**

All Revenue Bonds except for the Senior Series 1997 A-1 and 1997 A-2, Senior Series 1998 A-1 and 1998 A-2, Senior Series 1999 A, and Senior Series 2000 A-1, 2000 A-2, and Senior Series 2000 A-3 and Senior Series 2001 A-1 and 2001 A-2 and Senior Series 2002 A-1 and 2002 A-2 are tax-exempt issues.

Debt service requirements to maturity or redemption date, assuming interest rates on variable rate debt remains at June 30, 2004 levels, are as follows:

	<b>Principal Repayment Amount (Thousands)</b>		
	<b>83 GBR</b>	<b>97 GBR</b>	<b>Total</b>
Year Ending June 30, 2005	\$ 56,920		\$ 56,920
Year Ending June 30, 2006			
Year Ending June 30, 2007			
Year Ending June 30, 2008			
Year Ending June 30, 2009			
5 Years Ending June 30, 2014	46,000		46,000
5 Years Ending June 30, 2019			
5 Years Ending June 30, 2024			
5 Years Ending June 30, 2029	25,000	\$ 325,000	350,000
5 Years Ending June 30, 2034	<u>20,600</u>	<u>530,650</u>	<u>551,250</u>
Total	<u>\$ 148,520</u>	<u>\$ 855,650</u>	<u>\$ 1,004,170</u>

	<b>Interest Payment Amount ( Thousands)</b>		
	<b>83 GBR</b>	<b>97 GBR</b>	<b>Total</b>
Year Ending June 30, 2005	\$ 1,682	\$ 17,272	\$ 18,954
Year Ending June 30, 2006	1,499	15,396	16,895
Year Ending June 30, 2007	1,499	15,396	16,895
Year Ending June 30, 2008	1,499	15,396	16,895
Year Ending June 30, 2009	1,499	15,396	16,895
5 Years Ending June 30, 2014	5,615	76,978	82,593
5 Years Ending June 30, 2019	3,732	76,978	80,710
5 Years Ending June 30, 2024	3,732	76,978	80,710
5 Years Ending June 30, 2029	2,471	69,085	71,556
5 Years Ending June 30, 2034	<u>1,293</u>	<u>19,780</u>	<u>21,073</u>
Total	<u>\$ 24,521</u>	<u>\$ 398,655</u>	<u>\$ 423,176</u>

All assets of the 1983 General Bond Resolution Fund and 1997 General Bond Resolution Fund are pledged for repayment of the specific bond issues under each resolution.

**Kentucky Higher Education Student Loan Corporation**

June 30, 2004

**Note 9--Line of Credit**

The Corporation has a Line of Credit Agreement with Bank of America, N.A., providing for advances to the Corporation not to exceed an aggregate outstanding principal balance of \$100 million. The borrowing period ends December 31, 2004. During the year ended June 30, 2004, the Corporation drew down \$91,280,000 and made principal payments of \$50,000,000 on this line of credit. At June 30, 2004, there was \$41,280,000 outstanding.

**Note 10--Allowance for Arbitrage Liabilities**

Certain of the Corporation's tax-exempt bond issues subject the Corporation to potential arbitrage liabilities under U.S. tax law. Arbitrage liabilities, under current federal income tax law regarding tax-exempt bond issues, consist of three types; (1) yield adjustment payments, (2) forgiveness and (3) arbitrage rebate. At June 30, 2004, the Corporation is reporting a liability for yield adjustment payments and forgiveness of \$20,308,540 and for arbitrage rebate of \$184,299.

The determination of excess yield on acquired purpose investments is cumulative over the life of the applicable bond series, as is the determination of arbitrage rebate on non-purpose investments, except for variable rate bonds for which arbitrage rebate is generally determined for each five-year period without retroactivity.

Yield adjustment payments, which also relate to yield restriction on acquired purpose investments, are applicable to the 1991 Series D & E Bonds, 1996 Series A, Subordinate Series 1997 B, Senior Series 1998 B, Senior Series 1999 B, Senior Series 2000 B, Senior Series 2001 B, and any future issues except certain refunding issues. The allowable yield is 2% above the bond yield (arbitrage yield), with the federal special allowance included in income. The loss of tax-exempt status may be avoided by rebating the excess yield to the U.S. Treasury every 10 years, and upon final maturity of the bonds.

Forgiveness is applicable to the 1991 Series B & C, 1993 Series A, B & C, 1994 Series A & B, 1995 Series A, B & C, 1996 Series B, and 1997 Series A, B, C & D bonds. In general, a yield restriction is imposed on acquired purpose investments, designating the allowable yield as 1.5% or 2.0% above the bond yield (arbitrage yield). The loss of tax-exempt status may be avoided by partial forgiveness of the applicable student loans. Forgiveness can be applied upon maturity of the bonds or as otherwise prescribed by the bond resolutions.

Arbitrage rebate is applicable to all of the Corporation's tax-exempt bonds except the 1985 Series A. With certain limited exceptions, income earned on non-purpose investments (investments other than student loans), which exceeds the bond yield (arbitrage yield), must be rebated to the U.S. Treasury. Payments of at least 90% are due every five years after the year of issuance, and upon final maturity of bonds.

**Kentucky Higher Education Student Loan Corporation**

June 30, 2004

**Note 11--Credit and Liquidity Facilities and Bond Remarketing**

The 1991 Series E and 1996 A Bonds are collateralized with Standby Bond Purchase Agreements, pursuant to which Landesbank Hessen-Thüringen Girozentrale will purchase any bonds not remarketed. The 1991 Series E Bonds and the 1996 Series A Bonds also have a Municipal Bond Insurance Policy issued by AMBAC Indemnity Corporation and MBIA Insurance Corporation, respectively, which collateralizes payment of principal and interest on the bonds. The Standby Bond Purchase Agreements expires December 1, 2011 for the 1991 Series E Bonds and December 31, 2015 for the 1996 A Bonds. Unless it is renewed, the AMBAC Municipal Bond Insurance Policy extends through the term of the 1991 Series E Bonds, December 1, 2011 and the MBIA Municipal Bond Insurance Policy extends through the term of the 1996 Series A Bonds, June 1, 2026.

The Corporation pays certain fees with respect to its variable rate bonds to auction agents, broker dealers, market agents, remarketing agents, and tender agents for remarketing bonds or conducting auctions of bonds. These arrangements are generally cancellable with prior notice by either party.

**Note 12--Retirement Plan**

The Corporation provides retirement benefits to all full-time employees through the Kentucky Retirement System (KRS). KRS is a multiple-employer, defined benefit plan sponsored by the Commonwealth of Kentucky, which provides retirement, disability, and death benefits. The Corporation contributed 5.89% of gross wages for the year ended June 30, 2004. The employees contributed 5% of their gross wages to the plan for the year ended June 30, 2004. Such rates are intended to provide for normal costs on a current basis, plus an amount equal to the amortization of unfunded past service costs over thirty years, using the level percentage of payroll method. These contribution rates are determined by the Board of Trustees of KRS each biennium. The payroll of employees covered by the retirement plan was \$9,588,117 for the year ended June 30, 2004. Total payroll for the year ended June 30, 2004 was \$10,337,111. KRS participants have fully vested interests after the completion of sixty months of service, twelve months of which are current service. The KRS contribution requirement for the year ended June 30, 2004 was \$1,044,163, which consisted of employer contributions of \$564,750 and \$479,413 from employees in 2004. Although separate measurements of assets and pension benefit obligation are not available for individual employers, KRS's annual financial report (which is a matter of public record) contains this information for KRS as a whole.

**Note 13--Related Party Transactions**

The Corporation maintains a board of directors that mirrors the Authority's board of directors. In accordance with KRS 164.746 and 164A.050, the Corporation and the Authority maintain a board comprised of ten members appointed to the Authority's board by the Governor and five ex officio voting members.

Continued



Notes to Financial Statements--Continued

**Kentucky Higher Education Student Loan Corporation**

June 30, 2004

**Note 13--Related Party Transactions--Continued**

During the year ended June 30, 2004, the Corporation entered into a shared services agreement with the Authority that pertains to Information Processing Services and Technology, Collection Services, Internal Audit, Executive Management and Professional Support Services, Clerical Administrative and Technical Support Services, Creative Services, and Cooperative Procurement. During the year ended June 30, 2004, the Corporation provided services to the Authority valued at \$5,418,207. Also during the year ended June 30, 2004, the Authority provided services to the Corporation valued at \$2,157,653. The Authority paid the Corporation \$2.8 million for shared services during the year and the Corporation maintains a receivable at year-end for the remaining \$602,554.

The Corporation also maintains a loan origination and disbursement services agreement with the Authority. During the year ended June 30, 2004, the Corporation paid the Authority \$430,427 for loan origination and disbursement services.

Pursuant to a separate agreement, the Corporation provides escrow services for federal funds restricted for default aversion activities. During the fiscal year ended June 30, 2004, the Corporation expended \$814,579 of the escrowed funds on behalf of the Authority. At year-end, the balance of escrowed funds totaled \$703,201.

The Corporation reimburses the Authority for all direct postage changes related to the Corporation. The Corporation paid the Authority \$1,021,056 during the year ended June 30, 2004 for postage reimbursement. As of June 30, 2004, the Corporation owed the Authority an additional \$52,540.

During the year ended June 30, 2004, the Corporation made transfers totaling \$3 million to the Authority for support of state student financial aid programs, as approved by the Corporation's Board of Directors, pursuant to Section 508(c) of the 1983 General Bond Resolution.

**Note 14--Net Assets**

Restricted net assets consist of net assets of the Education Finance Funds as required by the 1983 and 1997 General Bond Resolutions, the separate Series Resolutions, and Line of Credit Agreements. Pursuant to action of the Board of Directors, unrestricted net assets at June 30, 2004 are reserved for the Corporation's operating expenses for the upcoming fiscal year.

Notes to Financial Statements--Continued

**Kentucky Higher Education Student Loan Corporation**

June 30, 2004

**Note 15--Operating Leases**

The Corporation leases office space and equipment under agreements expiring through 2009. The following are the approximate minimum lease commitments under operating leases:

<u>Year Ending June 30,</u>	
2005	\$ 775,000
2006	789,000
2007	714,000
2008	212,000
2009	194,000

**Note 16--Commitments and Contingencies**

The Corporation has entered into loan purchase contracts with various eligible lenders. Subject to the terms and conditions of these agreements, the Corporation on June 30, 2004, had plans to purchase approximately \$49.5 million of loans. These contracts cannot be terminated by either party.

**Note 17--Subsequent Events-2004 Bond Issue**

On August 10, 2004, the Corporation issued \$350,000,000 of Student Loan Revenue Bonds to continue its student loan finance program. The \$202,600,000 2004 Series A & B Tax Exempt Bonds are scheduled to mature on June 1, 2034, and bear interest rates that change every 35 days based on specified indices. The \$147,400,000 2004 Series A Taxable Bonds are scheduled to mature on June 1, 2034, and bear interest rates that change every 28 days based on specified indices.